Food Distribution
Business Transformation Project

Commodity Order Re-Engineering (CORE) Team

Final Report

A Recommendation Prepared for:

United States Department of Agriculture
Food and Nutrition Service
3101 Park Center Drive
Alexandria, VA 22302

Dated: August 18, 1999

Table of Contents

1. Introduction

1.1 Mission

The mission of the CORE Team is to significantly improve services to our customers – producers and consumers.

The following report contains the recommendations for business process changes of the Commodity Ordering process produced as a result of intensive examination, analysis, discussion, evaluation and interpretations by the Commodity Order Re-Engineering (CORE) team. It is our belief that the proposals provided herein will help the USDA in meeting its goal of providing significant improvement to the process and thus better service to its end users.

1.2 Background

The CORE team first met in December, 1998 and continued meeting monthly through June, 1999. To develop this proposal, the CORE team participated in a Business Process Re-engineering (BPR) process. BPR is a systematized method of stepping back and looking at a whole new way of performing a particular business process. It typically involves more *fundamental* change than people are used to. It is not about making small changes, and often means doing things in a completely or significantly different way. While keeping this in mind, the CORE team has developed this proposal for the new commodity system. Parts of this system incorporate an entirely new way of doing business for the USDA

It is assumed and understood that it will take an indeterminate period of time to develop and implement this final vision. Therefore, the Team also included some recommendations for interim and transitional steps.

This report provides details of the team's proposals. Part I contains a description of the final model. Part II is the list of recommendations. In order to avoid confusion, there are detailed explanations for each concept.

1.3 Team Membership and Oversight

The CORE team is made up of representatives from partner and customer groups. The membership for the CORE team is as follows:

Paula Cockwell (Team Leader), School Representative
(Commerce City, Colorado)
Gail Johnson, School Representative (Baton Rouge, Louisiana)
Barry Sackin, Formerly, City Of Anaheim School System, California
Rick Gresser, State Representative (Texas)
Karen Dean, USDA/FNS Regional Office Representative (Southeast Region)
Howard Magwire, USDA/AMS Representative
Dean Jensen, USDA/FSA Headquarters Representative
Peggy Cantfil, USDA/FNS Headquarters Representative
Marie Paddock, ALTA Systems, Inc. (Project Director)
Jeff Edwards, Alchemists Int'l. (Facilitator)

For this project, a Senior Oversight Committee (SOC) was put together to provide guidance to the team during the re-engineering project. The SOC is made up of key senior level staff from each of the agencies involved and is comprised of the following individuals:

George Braley, Associate Administrator, FNS
Ken Clayton, Associate Administrator, AMS
Vicki Hicks, Deputy Administrator, Commodity Operations, FSA
Maggie Glavin, Associate Administrator, FSIS
Ron Vogel, Associate Deputy Administrator, Special Nutrition Programs, FNS
Virgil Conrad, Regional Administrator, SERO, FNS

The entire effort is being overseen by the Commodity Improvement Council (CIC). The CIC was created as an outcome of the Commodity Reform Act of 1987 and had been meeting on a periodic basis prior to this BPR project. The CIC is comprised of the following individuals:

Mike Dunn, Under Secretary over AMS
Gus Schumacher, Under Secretary over FSA
Shirley Watkins, Under Secretary over FNS
Catherine Woteki, Under Secretary over FSIS
Administrators from the three agencies
Associate/Deputy Administrators

1.4 CORE Team Calendar

The CORE team members participated in an aggressively busy schedule during the 7 months of meetings. Aside from their regular jobs and these monthly meetings, they were also responsible for additional BPR related tasks and briefings which were to be completed between each meeting. The following is a calendar of events for the seven months in which the CORE team met. While only the major meetings and briefings are noted here, there were several other briefings of smaller groups that took place during this time that were given by individuals or small groups of CORE Team members.

December:

1st-3rd CORE Team Meeting

January:

5th-7th CORE Team Meeting

February:

2nd-4th CORE Team Meeting
3rd Meeting with SOC
5th Meeting with SOC

March

1st ASFSA LAC – CORE Team Briefing
4th-6th CORE Team Meeting
4th Meeting with SOC
6th Meeting with SOC
26th CIC is briefed by Project Coordinator
30th-April 1st CORE Team Meeting

April

8th Meeting with SOC
16th-20th ACDA Meeting and Briefings
27th Fruit and Vegetable Conference – CORE Team Briefing
30th ASFSA Leadership Conference – CORE Team Briefing

May

3rd Industry Meeting – CORE Team Briefing
4th-6th CORE Team Meeting
6th Meeting with SOC
7th Livestock Meeting – CORE Team Briefing
22nd ASFSA Major Cities Meeting – CORE Team Briefing

June

2nd-4th CORE Team Meeting
4th Final Presentation to the SOC

2. Part 1: Defining The Process

2.1 Overview

This section describes the model the CORE team *proposed* to USDA. The model follows two product tracks: bulk and finished. Products that USDA buys as ingredients requiring additional processing at an approved manufacturer (AM), follow the bulk track. They include items such as chilled bulk chicken and turkey, eggs in tanker trucks, barrel cheese and drums of tomato paste. Foods which USDA buys in their most complete form, those that are essentially ready to serve, follow the finished track. Finished products include items such as canned and frozen fruits and vegetables and peanut butter in #10 cans.

There are some items that may fall into both categories such as frozen peaches. In the case of frozen peaches, districts may elect to treat them as bulk items, finished goods or split between the two. For example, a district may have some frozen peaches in 20 pound cartons sent through the finished goods track for use in the kitchen, and some sent as bulk items to a processor to be put up in 3 ounce lidded cups or made into turnovers.

"Bonus Commodities", those purchased by USDA because of extreme fluctuations in the marketplace and distributed to school districts and other eligible recipients above their entitlement allocation, are treated the same as bulk items and finished goods depending on the form in which USDA buys them. The only difference between bonus and entitlement commodities is whether or not a district's entitlement is debited when the item is distributed.

A fundamental principle of the proposed model requires that USDA buy "closer to the hoof", where appropriate, thus expanding the dollars available to remove commodities from the market. By reducing the amount of commodity dollars expended to convert bulk ingredients into finished goods, more of the raw commodity can be made available to schools. Another advantage is that schools may specify their manufacturer of choice as well as the end product they will receive. Buying whole chilled chickens rather than breaded chicken is an example. Another example is buying boneless boxed beef combos rather than lean ground beef patties. Nevertheless, the CORE Team has heard from a number of districts that would still like to receive items like raw fine ground beef directly. For schools that have invested in production kitchens and can find ample labor, this is especially important. *In response to those requests*, the current proposal supports the ability for USDA to buy some of these items as they have in past years under the finished product track.

Companies that wish to process USDA commodities must become an Approved Manufacturer (AM) and enter into an agreement with USDA to receive commodities. Details of the CORE Team's recommendations regarding AMs are in Section 3 of this report.

The Team refers to the *CORE System* as a centralized computer program needed as the hub of the model. Some people perceived that this meant that control of the commodity program was shifting from the states to the federal government. In fact, the opposite is what the CORE Team has envisioned. That is, greater control of a district's commodity ordering would be placed at the local level with the local district communicating its commodity needs directly to USDA. The state agency would provide technical assistance and monitor data requests. However, they would no longer be required to filter or compile data. A Universal Communication System available to all districts in all states is critical for this shift to take place. This universal system would provide the framework needed to provide streamlined communication and uniform access to data among parties involved with the commodity program.

There has been considerable discussion about distribution of commodities. Currently there is a wide variety of commodity distribution systems. Some states have sophisticated warehousing and delivery systems. Some warehouses, contract out delivery or require districts to pick up commodities from the warehouse. Others utilize a network of commercial distributors or store and deliver commodities themselves. Equally varied are the charges paid by districts for these services. Several states receive state funding to underwrite some or all of commodity distribution and there are no fees paid by districts. Others have various charges for items like handling, storage, delivery, administration, etc.

Based on the feedback the Team has received, the definition of FOB (free on board) points has been left open. FOB points are the locations (destination points) to which delivery is paid for in a contract. For example, the price distributors pay for products bought to meet districts' orders include shipping from the manufacturer to the distributor's warehouse. The distributor then adds the cost of delivering to the district warehouse or individual schools into the district's price. If schools take delivery to a central warehouse, it is *FOB District Warehouse.* Individual school deliveries are *FOB school kitchens*. The determination of FOB for USDA commodities is not fixed in the model. It varies depending on the situation. It is likely that some states will continue to provide some distribution services to school districts.

2.2 The Model

2.2.1 USDA Develops Purchase Plan By Commodity By 3/1/xx

By March 1 of each year, USDA announces its market support plans for the following year. For example, USDA might state that they will buy beef, peaches, apricots, chicken and turkey, etc. This allows school districts to begin to develop their plans for procurement for the following year.

- When the announcement is made, USDA will list finished and bulk track ordering options, approved manufacturers (AMs), including products available and their end product data schedules (EPDS).

- The schedules will provide the yield data necessary to translate cases of finished product needed into the amount of commodity ingredients to be directed to the AM on behalf of a district. The specific information required on an EPDS will be determined when USDA selects the method that will be used to pass the value of commodities on to the district.

2.2.2 USDA States Intent To Buy By 4/30/xx

By the end of April each year, the Department will publish its estimates of market support by market. The report will indicate specific markets and whether support will be less, the same or more than current procurement levels.

- The information will be consolidated on a single existing web site under a universal communication system, rather than the current patchwork of sites, series of FNS memorandums and/or newsletters.
- Included in the system will be the district's estimated PAL (planned assistance level, aka entitlement) by product group; that is, each district's potential fair share allocation by product group.
- After posting, schools will access specific information by product about USDA purchase intentions. This will be available on the Internet so districts can more accurately estimate to what extent USDA commodities will fulfill their food purchasing needs for the next year. During the transition to the new technology, there needs to be a way to get this report to schools that do not have access to the Internet. On the other hand, access to the Internet is expanding very rapidly and use of electronic communications is well established. It has been noted that states are increasingly requiring electronic transfer of claims data. In fact, one state has accepted only electronically transmitted reimbursement claims for the past five years.

2.2.3 Schools Communicate District Purchase Decisions To USDA By 6/30/xx.

School Districts will continue to use whatever method they choose to plan their procurement (product selection and pricing) – bidding, formal or informal price quotes, prime vendor relations, etc. School districts communicate their total yearly purchasing decisions *for finished commodities or processed goods that could include bulk commodity ingredients* to USDA.

- In communicating needs to USDA, recipient agencies (RA) will forecast needs on a monthly basis *regardless of the availability of commodities.* For example, a district may anticipate serving an AMs chicken nuggets once a week in October. If a single serve of chicken nuggets for the district is 25 cases and there are 5 weeks in October, the district would report a demand of 125 cases. The district has planned to serve the chicken nuggets even if USDA does not buy chicken. However, if USDA does buy chicken, the computed amount of raw chicken needed to produce the nuggets to fill the district's demand will be directed to the district's AM.

- *For bulk items*, RAs will enter estimated purchase quantities by AM, by product, by month. This information will be converted into pound requirements for diversion to AMs. Once the raw ingredient is received at an AM, RAs may have the option of shifting among the products offered by the AM.
- *For finished goods*, RAs will enter estimates of minimum and maximum quantities of the items desired. That is, a district may elect not to take any of a particular item (this is true for bulk items also). However, if more were to be available than the district's share, the district would indicate they are willing to accept it. For example, a district may plan on serving canned peaches once a week. The district needs 25 cases for one serve. But if more peaches were made available, the district would serve them more often. So the district would accept their entire fair share and indicate more is acceptable if another district doesn't take all of their allotted amount. This might look like (for October again) minimum: 125, maximum: 200.
- The districts' forecast report will identify where USDA is to ship the commodities within the network of FOB points established. That is, bulk items will be FOB the AM, districts may also specify where AMs should deliver end products. Finished goods will be FOB whatever point is determined to be closest to the school district, which is cost effective for USDA to include in their bid for distribution. This may be a state warehouse, a district's commercial distributor, or, for direct ship agencies, the district's storage facility. Where distribution services are not available, a USDA regional prime distributor may be an option. As stated above, there may be a variety of FOBs depending on local, state or regional needs.

2.2.4 USDA Initiates Procurement And Communicates Decisions (Ongoing)

After receiving procurement plans/orders from the school districts, the system will allocate their commodities. On the first pass, the system allocates the fair share to each district. If some district's maximum request is less than their fair share, and therefore, the total is less than the planned market support level, the system would make additional passes, reallocating evenly up to each district's maximum request as long as there is product available.

- When the allocation process is completed, each district accesses a report of their total anticipated allocation by commodity, assignment to AM or FOB, and projected delivery date(s).
- USDA will use *Indefinite Delivery/Indefinite Quantity* (ID/IQ) purchasing. ID/IQ is a method whereby the USDA may indicate a guaranteed minimum quantity to be purchased over the term of the contract and an estimate of the maximum that may be bought. Prices are fixed over the period of the contract, usually with allowances for exceptional market fluctuations. Specific delivery dates are determined later. USDA currently uses this method when procuring cheese.

2.2.5 Commodities Are Delivered As USDA Purchases And Are Matched With School District Needs. (Ongoing)

- *For bulk items*, commodities are delivered to the AMs. At this point, a district's share of product purchased on their behalf is established at the AM. This may be in the form of pounds, dollars or credits, depending on the method approved by USDA for passing the value of the commodity through to RAs. A complete discussion of the plans submitted by the CORE Team is included in Section 3.
- *For finished goods*, deliveries are to the FOB point chosen by the RA from the list of approved delivery locations.
- All stakeholders, i.e. districts, distributors, state agencies, warehouse staff, manufacturers, USDA vendors and USDA staff will have access to consistent ordering, purchase and delivery information pertinent to their area, to allow all parties to effectively and efficiently operate and monitor their portion of the commodity program.

3. PART II: Recommended Policy & Practice Changes

The CORE Team's recommendations to USDA are based on the framework of the eight concepts the team developed for designing a new improved commodity program. The recommendations are related to those eight concepts and are designed to fulfill the mission of the project. There are two objectives. First is to resolve the problems and concerns that were identified last September at the meeting of the Commodity Improvement Council (CIC). Second is to present a proposal that would create a commodity distribution system that fulfills the charge given to the CORE Team: "*to significantly improve service to our customers – producers and schools"*.

The model presented in Section 2.2 addresses the original concerns and defines the system proposed to facilitate an effective commodity distribution program. The recommendations in this section, speak to the policy and practice changes that are needed to make the model work.

There are more than 30 order fulfillment re-invention recommendations. The general recommendations are not specific to the eight CORE concepts, but rather address concerns and/or process issues that may need to be resolved before implementing a new improved system.

3.1 General Recommendations

3.1.1 Streamline Commodity Procurement

Currently there are several offices involved in various commodity order fulfillment activities: FNS Regions, FNS Headquarters, FSA Kansas City Commodity Office, FSA Headquarters and AMS Procurement Branches. USDA should streamline all commodity procurement functions within the three agencies (AMS, FSA and FNS) in such a way that one entity has the overall responsibility for the commodity distribution process. Under the current system, partners in the commodity program may have to talk to individuals at three or four locations to resolve questions or problems. There needs to be a single point of contact for a constituent. *The CORE Team is not advocating a consolidation of agencies or reassignment of staff. It is recommending that any separation of authority or responsibility among the agencies be transparent to the customers and that information regarding the program be available from a single source.*

3.1.2 Full-Time Reinvention Project Team

USDA should establish a full-time tri-agency project team responsible for developing and managing implementation of agreed upon recommendations from the transformation team. This team should be managed by the Senior Oversight Committee that was established as part of the BPR process and report

re-invention progress from a single website, reporting updates and success stories so that all partners in the commodity program are informed of the progress as changes roll out. There is considerable interest and support within all three agencies to implement effective change to the commodity program. To ensure continued efforts toward meeting the goals of the reengineering project, a work group needs to be created which has the authority to make the necessary changes to policies, regulations and practices, which will be required to facilitate the implementation.

3.1.3 Constituent Advisory Group

USDA should have an advisory group to support the implementation team. It should be comprised of representatives from various constituent and partner groups, but not to include members of the CORE team. One reason that the reengineering process has progressed so far in a relatively short time is that the teams had representation from a variety of constituent groups. This brought together individuals with expertise in the commodity program who could complement each other's knowledge and understanding and ensure a comprehensive analysis. This process should be continued into the next phase.

3.1.4 Demonstration Project:

USDA should demonstrate the CORE proposal by school year 00-01. Developing and implementing a new universal communication system as soon as possible is one of the goals. However, it is likely that it will take some time to design and create the system needed. Also, there are some areas which need refinement that only real-time testing can make possible. Therefore, it is recommended that a demonstration group be identified which is representative of the variety of customers that the commodity program serves. The CORE team recommends a representative sample to be a variety of small and large school districts and states, and urban and rural distribution destinations. This demonstration should be operational no later than the '00-'01 school year.

3.1.5 State Administrative Expense Funds

USDA should administratively adjust the Food Distribution State Administration Expense (SAE) funding to provide State Distributing Agencies (SDA) with adequate federal dollars to perform required functions without having to pass their costs on to schools. Incentive provisions for enhanced SAE funding should be included to encourage superior performance, as should fiscal sanctions for unacceptable performance.

3.1.6 Alternative Outlets for Bonus Products

USDA should allow additional outlets, such as prisons and charitable institutions, to receive commodities that schools cannot use and/or don't want. One of the earliest concerns expressed about the current commodity distribution

system is the distribution of unpopular food items procured by USDA to meet its statutory obligation to support markets to schools. With the demand driven model, schools may refuse any bonus commodity item offered. Therefore, USDA needs to expand distribution to other institutions that are better able to utilize commodities that are either undesirable or hard to use within the school programs.

On the other hand, commodity producers are obligated to develop demand for their products among school customers if they want schools to use them. For example, fig nuggets (which are distributed as bonus commodities, not entitlement) are difficult to use in the form in which they are currently shipped to schools. However, an entrepreneurial company might be able to package the fig nuggets along with other ingredients such as raisins, pitted prunes and peanuts, as well as non-commodity ingredients, as a 2 ounce trail mix package for a low cost to districts. Similarly, prune puree, another bonus product, is a hard to use product if a district is not doing scratch baking. However, several bakeries are developing low-fat cookies, breakfast pastry and cakes using it and selling them to schools, and several beef patty manufacturers are developing products, yielding a lower fat, moist hamburger patty.

3.1.6.1 Alternatives for Small Outlets

In some cases it is not practical to administer and deliver commodities to small programs or districts. There is a precedence for providing cash options for NPE and AAA. Therefore, USDA should consider allowing a cash-in-lieu option for programs and districts below an established threshold.

3.1.6.2 Paperwork Burden Reduction

With the aid of affected parties, USDA should evaluate all reporting requirements to determine the necessity or redundancy of reports and processes. USDA should continue their efforts to eliminate and reduce paperwork. Furthermore, this should not necessarily be tied to the implementation of a new system.

3.2 CORE Concept Recommendations

3.2.1 Seamless Ordering/Purchasing/Distribution

Since commodities account for approximately 20% of a school districts food needs, one of the goals of the commodity reengineering project is to make commodity processes match, as closely as possible, the processes used by school districts for the other 80% of their food purchases. In other words, have a 100% supply of food products from the same channel, or a compatible channel, i.e. one that does not disrupt commercial procurement operations. The model provides the framework to do this. There are several additional issues/areas

which the CORE Team has developed recommendations that would provide a more seamless and even product flow.

3.2.1.1 Use Of Prime Distributor(s) As Appropriate

USDA does a commendable job procuring certain finished goods. Under the current system, USDA purchases finished goods FOB to one of three places: state warehouses, commercial warehouses (either for states or direct ship agencies and cooperatives (co-ops)), or district warehouses for direct ship agencies. The team recommends that USDA contract with one or more prime distributor(s) who would consolidate several USDA purchased commodities in quantities that can be used within a reasonable time frame, for delivery to the above FOB points. Furthermore, research indicates that some of the potential bidders for this service may have the ability to redistribute from their regional facilities directly to individual districts, alleviating some of the current problems of getting distribution to small, rural districts. The cost for this *redistribution*, when needed, would be borne by the customer (user). Some schools, if they choose, could possibly pay the cost to have school site delivery. This would be a potential added benefit of developing a prime distributor network. Utilizing USDA's great purchasing and contracting power can take advantage of the economies of scale, thus making it possible to provide value-added service to those districts that are having increased difficulty in soliciting bids and contracts for distribution.

3.2.1.2 Offering Of Group B Dollars To Districts

Group B commodities (dairy & cheese, grains, nuts) are purchased by USDA under a different section of law than Group A commodities. Unlike Group A, these items are not direct market support. The only limiting factor on how much of these items a district can receive is their Planned Assistance Level (PAL) and the availability of funds for Group B products. To simplify a district's allocation to Group B, the CORE Team recommends that the Group B funds be divided into fair share allocations to each district. That is, a district would be informed as to how much of its PAL is available to be used for purchasing items from the Group B list. A district may place orders by item, up to its fair share amount, as these items fit into menus. Taking less than its fair share of B dollars will increase availability of entitlement for Group A for the school district.

3.2.1.3 Utilize Section 4 & 11 Money To Purchase Additional Commodities

Under some circumstances, it may be to a district's advantage to "piggyback" on USDA's procurement of a specific commodity. Where commodities fall short of supplying 100% of a district's need for a product, additional product could be ordered to complete the supply. This could happen seamlessly and with possible savings to the district. For example, using long-term contracting, USDA might negotiate a lower price for cheese than districts would be able to, due in great part to the volume of product purchased. This

practice would allow a district to place orders for additional cheese, to be delivered either to the district or an AM. Payment for these purchases would come from federal funds received by districts for school meals. USDA should promote, facilitate and expand this practice.

3.2.1.4 Expand DOD Fresh Produce Pilot

While the DOD Fresh Produce Pilot is not within the scope of the CORE Team's charter, they received considerable comment about it and felt it incumbent on them to respond. Originally, the program was developed to improve the availability of fresh produce in keeping with the Department's commitment to improve the nutritional quality of school meals. To do so USDA sets aside $25 million per year to be allocated to states on a first come, first serve basis for participation in this program. For many participating districts, this allocation is not sufficient to fulfill 100% of a district's total demand for fresh produce. DOD Fresh Produce is very popular, particularly where both the state and the local or regional DOD facility have been able to fully utilize the system's potential by augmenting DOD fresh purchases with Section 4 and 11 money and thus filling 100% of a district's fresh produce needs through this channel. The CORE Team believes that the pilot has served its purpose and thus merits expansion. Therefore, it is recommended that the pilot be replaced by a full-scale implementation where districts wishing to participate may enter into a vendor relationship with DOD and all payment is made from section 4 and 11 money. This recommendation has implications outside of the scope of commodity distribution, and may require coordination with state child nutrition agencies.

3.2.1.5 Promote Cooperatives

USDA should encourage and assist in the development of co-ops. Over the past several years, an increasing number of districts have joined together to increase buying power. This has resulted in decreased costs and increased accessibility to processed items and distribution services. The CORE Team believes this is a very effective model for schools and encourages USDA to work with states in assisting expansion of this concept.

3.2.1.6 Promote Direct-Shipments

Along similar lines, current regulations allow districts which have the capacity, to accept USDA direct drop-off of commodities. Even now, these "direct ship agencies" can divert truckloads of bulk products to approved manufacturers who have processing contracts on file with the state. It is the state's responsibility to facilitate this activity. However, to sustain volume in a state distribution system some states discourage direct deliveries and diversions to processors, even where feasible and more cost effective for the district. Where there are individual districts or co-ops that qualify for direct shipment, USDA should help remove barriers to their participation.

3.2.1.7 Remove Truckload Barriers

Currently, there is an arbitrary limit of two stops per truck for USDA products. States must order full truckloads of bulk product to processors. This is intended to keep delivery costs down, to maximize the amount of available money actually spent on food and to ease program administration. However, sometimes this increases recipients' costs, creates excess inventories and reduces services to districts. Given the elimination of state borders by pooling of commodities either to AMs or district FOB points, it is recommended that flexibility be built in that would increase the number of stops for a truck and permit less than truckload quantities (LTQ) be ordered to processors.

3.2.1.8 Distribution Process Cost Analysis

USDA should define a distribution process which provides commodity distribution to school districts on time, and at a cost not to exceed the full cost of comparable commercial product. This distribution process must be flexible enough to meet the intent of the Commodity Reform Act of 1987, but robust enough to handle the impact of potentially reduced volume through state systems. The Commodity Reform Act of 1987 requires states to *evaluate the cost of commercial distribution versus state warehousing and distribution.* As a result of their findings, many states have moved to commercial distribution systems to some extent. One of the goals of the new system is to ensure that the cost to schools for commodities is competitive with their non-commodity purchases, including the cost of distribution.

3.2.2 National Approved Manufacturers

Currently, a processor that does business in several states must have an approved contract with each individual state. While USDA has provided a standard form for these contracts, there are slight variations among the states. There are also different production, inventory, accounting and auditing requirements. This is cumbersome for manufacturers and in some cases discourages participation or increases costs. USDA should consolidate processing contracts into a single agreement. As previously stated, participating AMs may self-determine the extent of their participation both in terms of capacity and geographical limits.

3.2.2.1 Contract

USDA should use the existing ACDA prototype processing contract as the baseline for the new contract for AMs. It is recognized that there will need to be modifications in the current contract to make it applicable within the new system. The CORE Team recommends that existing resources, including ACDA's processing committee, be utilized to develop the new contract based on the existing model.

3.2.2.2 Commodity Cost Per Pound

USDA should use an annual commodity file value for products shipped to AMs (for AM accountability purposes) and use actual purchase prices for tracking PALs. Currently, there are two prices used in the commodity program. The first is the actual price paid for each truckload of products purchased by USDA. Depending on seasonal and other factors, this price varies. The CORE Team recommends that this actual price be used in determining the value of a commodity for the purpose of debiting a district's PAL account. On the other hand, processors are held accountable for commodities once they receive them. Since commodities are recommended to be 100% substitutable (see below), it would simplify the process if a set price called the "annual commodity file price" was used to determine the value of a commodity once ownership has transferred to the AM.

3.2.3 Substitution With Quality Control

A fundamental recommendation of the CORE Team is that USDA commodities be substitutable with ingredients commercially procured by an AM, just as cheese is currently 100% substitutable. Without substitutability the program loses its ability to blend seamlessly with 80% of foods purchased by RAs that are not commodities. Substitutability significantly reduces cost by eliminating separate production, inventory and tracking systems and also reduces storage and handling costs. It improves food safety by moving USDA purchased foods into the product stream faster on a first-in first-out basis. It can mean seamless inventory at the district level.

There are potential cost and AM participation implications surrounding the issue of substitutability. Therefore, the CORE team is recommending that USDA study and report on the impact of *not* requiring AMs to use domestic, certified ingredients and continuous grading when making products under substitution that may or may not be going to schools.

The CORE Team has two comments regarding quality control. First, the quality control system used by manufacturers to ensure customer satisfaction is as important as mandatory systems imposed by USDA. After all, failure to produce quality products is a sure road to failure. Second, a variety of random checks and a strong audit system with stiff penalties for non-compliance should be compelling. Therefore, the team recommends the expansion of the existing USDA initiatives to eliminate the requirement of continuous grading.

Approved Manufacturers should be required to agree, as part of their AM contract with USDA, to automatic, serious sanctions (included as part of the contract) if they are found in non-compliance with agreed upon specifications. These sanctions should be progressive in nature beginning with a fiscal penalty that is large enough to be an effective deterrent and then going to contract

cancellation and program disqualification for 3–5 years on the second offense. Compliance could be monitored by random physical checks and paper audits.

3.2.4 Purchasing "Bulk Ingredients" as Appropriate

As previously discussed, the more bulk product USDA buys, the more product they remove from the market, which better serves our customers. Additionally, the more products that USDA buys in their raw ingredient form, the more control RAs have regarding the processor and specification of end products.

As an example, boneless boxed beef combos may sell for approximately $.75 per pound whereas coarse ground beef may sell for $1.00per pound. Buying boxed beef may yield about a 33% increase in the amount of product USDA buys. Furthermore, the district can then direct its share to the AM of choice and order beef patties, sliced beef, cooked crumbles or meatballs, etc. that meet its specific requirements.

3.2.5 Use Of Industry Standard Specifications

One of the concerns with current commodity purchases is that AMs must adapt their formulations to accept raw ingredients purchased under USDA specifications. While USDA specifications and standards demand high quality, they are not seamless with the manufacturers' production used for the 80% of food purchasing that is non-commodity. Furthermore, there might be a number of subtle variations in a specification for a specific manufacturer. For example, the use of standard specifications will allow USDA to purchase fruit canned in the standard industry pack, which is heavy syrup, thereby streamlining procurement and production for the USDA vendors.

In producing bread, a bakery's specification for flour might fluctuate on a weekly basis depending on season, weather and a number of other factors. The details of a specification include factors such as moisture content, protein, ash levels, etc. Currently, USDA develops a specification for flour that establishes a range of acceptable values against which an AM can order from the flour mill.

USDA should expand this concept.

3.2.6 Long-Term Contracting

The CORE Team recommends that USDA contract on a long-term, best-value basis for commodities. The period of performance should be for the school year. This procurement method brings consistency and predictability to the commodity program.

- Under the current program, there is always uncertainty about what vendor will be successful on any given bid. When USDA is letting as many as 12 –

18 bids a year for a product, AMs cannot develop a relationship with the USDA supplier as they do with their other suppliers. USDA vendors tend to bid when they have under-utilized capacity and, because USDA contracts tend to be more exacting, USDA is sometimes the customer of last resort.

- USDA has an obligation to support small and minority-owned businesses. With long-term contracting, a small business can make the modifications needed to accommodate government contracts with the certainty of a predictable business for a given period. The long-term contract can be helpful in obtaining bank credit at lower rates, etc.
- There is always an amount of uncertainty in USDA commodity procurement because, for the most part, the commodity program is a market support program. It is intended to remove surpluses that the market cannot distribute. Therefore, projected market support amounts are subject to change. This is particularly true of fruits and vegetables where weather can significantly alter the market supply, plus or minus. However, it is believed that long-term contracting will help to reduce the amount of uncertainty in the procurement arena.
- The other critical element of this recommendation is “best value” purchasing. As school food service buyers know, the lowest price isn’t always the best value to the district. Other factors including quality, student acceptance, service, etc. are also important. USDA recently switched to best value procurement with peanut butter, using sensory panels to determine which products to accept under bid. This practice should be expanded.

3.2.7 Streamlined Universal Communication System

To provide a common source of pertinent, critical information to districts, distributors, states, AMs, and other partners, the CORE team is presenting a series of system design considerations as well as transition and communication approaches to establish a universal communication system.

The universal communication system could serve as:

a) A source of information and education for districts

b) An offering and ordering system that provides entitlement data and directs purchase data to USDA

The system should at a minimum:

a) Communicate purchase plan information

b) Report districts PALs and provide ordering options and projected commodity levels

c) List AMs, products, distributors and yield information, and translate end items needed into bulk material requirements

d) Analyze the cost and benefit of receiving specific forms of commodities

e) Compile data for an equitable, demand driven commodity offer and acceptance process

f) Report the status of commodity purchases and deliveries to all partners – districts, distributors, manufacturer, states, USDA vendors, etc.

g) Issue bonus commodity alerts

The following includes implementation, transition and communications approaches as well as an interim plan. The CORE team recommends that USDA:

- Review existing automated systems used by states, co-ops, the private sector and possibly other federal agencies to determine what is already available that could be adapted. Special consideration should be given to systems or modules of systems, that were paid for with public funds. The team is aware that a number of Internet based commercial, federal and state systems may be adaptable to the proposed Universal Communication System. Part of the Request For Proposal (RFP) process should include reviewing these. Furthermore, this should be done as soon as possible to provide an infrastructure for consistent communication.
- Establish a system user group (schools, distributors, states, USDA, AMs) to develop user requirements, system specifications, business rules, operating expectations, etc. The user group should start as soon as possible and actively participate in the development process.
- Strive to develop and install the system by January 1, 2001. The team recognizes the complexity of the proposed Internet based system. Nevertheless, the team feels its development and deployment should be a priority. The actual date may be negotiated or established in the development of the RFP, but it should be a date certain.

In the interim, USDA should explore the communications facility offered by the Internet and develop a system that is accessible at the RA level as soon as possible. Many of the features of an information/communication system can be implemented quickly, including USDA procurement plans and purchases, as well as the AM database. The recommendation that USDA plans are communicated to all concerned parties, and that all AMs can have their end product data schedules (EDPS) made available to all districts is a good first step. Therefore, it is further recommended that USDA:

- Post a list online of AMs by product/manufacturer/EPDS/yields/ availability/geographic area and capacity by March 1, 2000. Currently each state maintains its own file of EPDS. This is redundant and does not add value. On the other hand, some manufacturers are limited in their capacity or ability to serve outside of an area or region. The proposal is to include all

processors but allow them to limit the scope of their service. The benefit of this to RAs is improved information about the availability of further processing. For AMs, this would increase dissemination of information about their products and services.

- USDA place intent to purchase information by 4/1/2000 on a website and send to states to further distribute where necessary. States will decide further distribution methods such as the use of faxes.
- Post online status of orders on the website for all partners, in one single easily accessible location. This information currently resides in many forms on the web, in EDI and different formats in state systems. RAs, distributors and AMs can immediately benefit from easy universal access to this data in terms of planning non-commodity purchases and production.
- Finalize purchases by December. Except for unusual circumstances and bonus buys, USDA has made firm commitments for most of its procurement for a given year by December of that (school) year. This information should be shared as soon as it becomes available. Knowing the balance of the year's commodity distribution will facilitate a district's working with distributors to smooth out needed quantities of non-commodity procurement.

3.2.8 Passing The Value Of Commodities To Schools

Certainly one of the most controversial parts of the CORE Team work to date has been the discussion of how to pass the value of commodities purchased by USDA on to RAs. That is, for every dollar USDA spends on buying commodities from one of its customers (the producer), an item valued at a dollar should end up at the school district level. While this seems a simple enough concept, it is complicated by many factors. First, the amount of value that a district is entitled to is limited by its PAL. The process must ensure that a district does not exceed its PAL while also ensuring that every district has the opportunity to receive their full share of commodity dollars.

Second is a concern that every district have an equal opportunity to receive a fair share of commodities purchased. The team believes that the order fulfillment system, as proposed, gives schools a better opportunity of getting their full PAL even if they choose not to accept some products. The sheer size of the market would indicate that by "pooling" commodities nationally, a balance can be achieved.

Over the last months of their charter, members of the team had a broad range of discussions with many parties. While there is still significant merit with the CORE rebate process originally presented in April 1999 at the American Commodity Distribution Association conference, several other options have been explored. There are pluses and minuses with all of the proposals. Therefore, the CORE Team presents all five approaches to the SOC and asks them to either select one or reduce the number of options and evaluate.

The following are descriptions of the five processes presented by the team. All five begin with the order fulfillment model presented in Section 2.2. The only difference is how the commodity value is determined and passed on to the school district level.

3.2.9 The Credit Process

When the commodity product arrives at an AM, it has a bill of lading or delivery order (DO). This DO includes a list of every district entitled to a portion of the product, and each district's share.

For the purpose of this discussion, we will say this is a truck containing 30,000 pounds of chicken whose value is $ per pound1 or $30,000 (the amount paid by USDA to buy the chicken). Furthermore, XYZ District is entitled to half of the truck or 15,000 pounds/$15,000. For the purpose of this discussion assign a fixed value of $10 for a unit to be called a "credit" (i.e., 1 credit = $10.00). When the truck arrives, the AM "books" 1500 credits to the account of XYZ District ($15,000/10). Also, the central computer notifies XYZ District that the AM has received half a truck of chicken on the district's behalf.

XYZ District buys whatever quantity of chicken nuggets it has determined to use for the school year from the distributor. The distributor orders more nuggets from the AM for XYZ District. The AM checks XYZ's account and sees that they have 1500 credits. It ships the district's order to the distributor discounting every case by $10 (one credit) as long as there are credits on the books. The distributor bills the district charging the discounted rate. This continues as long as there are credits available. If another truck arrives with additional commodities for XYZ District, these credits are added to their balance. The AM maintains a running balance of credits received and issued.

Now let's look at a multiple ingredient product like pizza. Pizza may have four commodity ingredients – flour, cheese, tomato paste and pork (for sausage). Each ingredient has a different cost and may arrive and run out at different times. Under the credit system this doesn't matter. If a truckload of flour arrives and XYZ District is entitled to $300 worth of the flour on the truck, the AM books 30 credits. The tomato paste might add 500 credits. The cheese is worth 2000 credits. The number of credits is always the commodity value divided by the value of a credit. On the receiving end, each case of pizza is discounted by one credit regardless of the amount or type of commodity it contains as long as credit is not given for items which could not be made from the commodity provided.

There are a couple of pluses for this approach. One benefit is its simplicity for financial accounting. AMs and RAs can easily track their accounts and whether the commodity value has been received by a district up to its PAL. Pricing is simplified as the discount is standardized. If a district is not receiving discounts when it knows that the AM has received commodities on its behalf, follow up is easy.

There are some questions and concerns with this approach. How do you determine the value of a credit? Is the flour contained in the pizza worth as much as the cheese? Should different ingredients determine the value of a credit? What about multiple ingredient products?

If the value is set too low, a district might have to order an exceedingly large quantity of end product to get its full credit. For example, if the credit is valued at $5 for beef patties that are substantially made of commodity beef with an entitlement value of $12 per case, the district will need to buy more than twice as many cases to get its full value. On the other hand, if the value is set too high, a district could clear its credits long before the AM has used up all of the commodity. For example, a fruit turnover may have only $2 worth of commodity fruit in a $20 case. If the credit is valued at $5, the district could take less than half of the end product that fruit makes and use up its credits.

3.2.10 Fee For Service Process – Method 1

Fee for service is a method whereby an AM calculates the cost of producing a product minus the value of an ingredient or several ingredients that are supplied, at no cost to the manufacturer, by USDA. Using our chicken nuggets again, the AM takes the cost of the other ingredients in the nuggets, plus the cost of labor to produce them, plus other administrative and overhead costs allocated to the production of the nuggets, and determines the price of a case of these chicken nuggets. The price per case does not include the cost of the chicken that the USDA purchased and provided on behalf of the district.

Under method 1, the AM has two prices to the distributor for a standard case of chicken nuggets. The first price is the regular (non-commodity) price negotiated between the AM, the distributor and the school district. The second is the price of a case with USDA commodities and the AM only charges the other costs of producing the nuggets, i.e., the “fee for service”. Similarly, the distributor has two prices in its billing system. When the AM fills an order for a district where the AM has received commodities for a district, it ships product at the fee for service price rather than the non-commodity price.

The pluses in this process are there are no rebates to be issued. Also, for the AM, the price USDA pays for a commodity does not impact the cost of producing the products. It is fairly simple to administer.

On the negative side, pricing products that use multiple ingredients is very difficult. Our example of pizza with four potential commodity ingredients would require 16 different prices depending on the combination of commodities used in producing a case. Furthermore, since all commodities are substitutable, specific cases of product are never identified for a specific district. So all of the calculations must be done on paper. Different districts assign different ingredients to different AMs in different amounts. This can lead to confusion and difficulty for both the AM and the district to track the commodity value.

3.2.11 Fee For Service Process – Method 2

This is identical to method 1 except that billing for the product goes directly from the AM to the district. When a distributor orders product from a manufacturer for a district, the AM ships commodity product at no charge to the distributor and non-commodity at the agreed upon price. The distributor charges a handling fee to the district for receiving and delivering a case of commodity product. For larger districts or coops, the product could still be delivered directly from the AM to the desired location.

The pluses of this process are similar to method 1. Also, it eliminates distributors having to maintain multiple pricing. The disadvantages are also similar to method 1 with the addition of creating a problem for distributors who normally calculate shipping and handling charges on the value of the product. This is a legitimate basis in that they have more money tied up in a higher priced item than they do in an inexpensive one. A portion of their handling charges reflect their cost of money. Also, it would require a district to issue two payments for a commodity, one to the distributor and one to the manufacturer.

3.2.12 Rebate Process – Method 1

When a truck of commodities arrives at an AM, the AM books the commodity file value on a per case basis of end product. This amount is carried on the AMs books.

In this approach, school districts order and distributors deliver products seamlessly. There is no difference in product or price through the system. However, on a periodic basis, the district submits proof of purchase to the manufacturer who issues rebates for all the cases for which there is a commodity value on the books.

The pluses of this process are that it simplifies purchasing for the district and the distributor. It is truly seamless on the procurement end. Also, it allows issuance of rebates as soon as the AM receives the commodities and, because of substitutability, even retroactively reimbursing for product already sold and paid for.

The down sides are that it creates additional paperwork for school districts. Also, it means districts don't get the value of the commodity until they submit the rebate request and the AM issues the check. For some districts this may create a cash flow problem as they are paying full price for everything. Lastly, there is a concern about reconciliation when districts do not submit rebate claims in a timely fashion.

3.2.13 Rebate Process – Method 2

This is the original rebate process for which the CORE Team received feedback in April. When a truck of commodities arrives at an AM, the AM

rebates the commodity file value of the item, on a per case basis of end product, to USDA.

In this approach, school districts order and distributors deliver products seamlessly. There is no difference in product or price through the system. However, on a periodic basis, the district submits proof of purchase to USDA who issues rebates for all the cases for which there is a commodity value on the books. USDA issues these rebates electronically on a regular basis.

The pluses of this process are that it simplifies purchasing for the district and the distributor. It is truly seamless on the procurement end. Also, it allows issuance of rebates as soon as USDA and the AM have completed their transaction and because of substitutability, reimbursement could be retroactive for product already sold and paid for. Schools should have a much better opportunity to meet their PAL with improved tracking and accountability.

The down sides are that it creates additional data entry for school districts. Also, it means districts don't get the value of the commodity until they submit the rebate request and the AM issues the check. For some districts this may create a cash flow problem as they are paying full price for everything. Lastly, there is a concern about reconciliation when districts do not submit rebate claims in a timely fashion. In addition, small processors might need to be given a 90 day payment period for making payment to USDA for the raw product in order to ease their cash flow.

While this approach has raised considerable controversy, the team felt that there are also benefits, and asked the SOC to include it in their evaluation and selection process.

4. Conclusion

This concludes the final report of the CORE Team. It has been a challenging seven month odyssey as the team struggled to meet the charge of not simply fixing the existing commodity distribution program, but to create a new commodity distribution system that would meet the needs of both customers – producers and consumers – as well as the many partners who work together to make the current system work. From the first several meetings where each member of the team learned just how complex the overall program is, as well as the complexities of each other's jobs, to the challenges of gathering information from all of the partners in the commodity program; from communicating the team's activities, to responding to the questions, myths and misunderstandings that arose as more and more people heard about the work; from the difficulties in forming a team that could work together on this most difficult task, setting aside personal interests for the good of the project, to the strong bond that develops among people who respect each other for their knowledge, skills and contributions to the whole; this has been a great experience for us. We fervently hope that our efforts will result in a commodity distribution program that will serve us all well into the next millennium.

One of the very positive benefits of the commodity reengineering project that has all ready occurred, is that virtually all partners in the process have taken time to look hard at the current system and seek ways to improve it. A lot of really good ideas have come from this effort. Several states are looking at ways to improve the effectiveness of their state systems as well as ways additional value added services could be offered to recipient agencies. The concepts that have been shared with the CORE Team members are very exciting and promise to significantly improve services to school districts and agriculture. The CORE Team would like to take this opportunity to thank everyone for their contributions to this nationwide re-invention effort.